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February 3, 2015

TO: Supervisor Michael D. Antonovich, Mayor
Supervisor Hilda L. Solis
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe

FROM: John Naimo
Auditor-Controller

SUBJECT: **DEPARTMENT OF PUBLIC WORKS – COMMITMENTS, ACCOUNTS PAYABLE, AND TRUST FUNDS REVIEW**

As part of the Auditor-Controller's ongoing responsibility to ensure County resources are safeguarded and used effectively and efficiently, we continue to periodically review County departments' fiscal operations. These reviews evaluate department compliance with the County Fiscal Manual (CFM) and other County policies and procedures.

We have completed a review of the Department of Public Works' (DPW or Department) commitments, accounts payable, and trust funds. Our review included interviewing the Department's management and staff, examining records, and evaluating oversight. DPW manages budgets totaling over \$1 billion. At the beginning of Fiscal Year (FY) 2012-13, DPW had \$180 million in commitments to pay for goods and services that were ordered, but not received, in prior FYs. DPW also had \$9 million in accounts payable for goods and services that were received in prior FYs, but not paid for. In addition, DPW has 28 trust funds, totaling over \$37 million that are comprised of approximately 100 sub-accounts.

Summary of Findings

DPW generally established encumbrances and processed trust fund transactions in accordance with County requirements. However, DPW needs to review commitments, accounts payable, and trust funds, and cancel them if no longer needed. DPW also needs to strengthen trust fund controls and ensure money is transferred or disbursed

timely. DPW's response indicates that they have taken corrective actions to address these issues. The detailed findings and recommendations are included in Attachment I.

Review of Report

We discussed the results of our review with DPW management. They generally agreed with our findings and recommendations. DPW's attached response (Attachment II) describes the corrective actions they have taken, or plan to take, to address the five recommendations in our report.

We thank DPW management and staff for their cooperation and assistance during our review. Please call me if you have any questions, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:RS:YK

Attachments

c: Sachi A. Hamai, Interim Chief Executive Officer
Gail Farber, Director, Department of Public Works
Audit Committee
Public Information Office

**DEPARTMENT OF PUBLIC WORKS
COMMITMENTS, ACCOUNTS PAYABLE, AND TRUST FUNDS REVIEW**

Background and Scope

The Department of Public Works' (DPW or Department) Fiscal Division is responsible for the Department's commitments, accounts payable, and trust funds. DPW manages budgets totaling over \$1 billion. At the beginning of Fiscal Year (FY) 2012-13, DPW had \$180 million in outstanding commitments to pay for goods and services that were ordered, but not received, in prior FYs. DPW also had \$9 million in accounts payable for goods and services that were received in prior FYs, but not paid for. In addition, DPW has 28 trust funds, totaling over \$37 million, which are comprised of approximately 100 sub-accounts.

We have completed a review of the Department's commitments, accounts payable, and trust funds. Our review was primarily focused on evaluating DPW's compliance with the County Fiscal Manual (CFM) and other County policies and procedures. Our review included interviewing DPW management and staff, examining records, and evaluating oversight.

Commitments and Accounts Payable

County departments establish encumbrances to reserve budgeted funds when they order goods and services. At the end of each FY, the encumbrances are carried forward to the next FY as commitments if goods and services were not received. If the goods and services were received, but payments were not made, departments must establish accounts payable at year-end to recognize expenditures.

Both commitments and accounts payable reduce the County's available fund balance. While accounts payable are automatically canceled at the end of the following year, commitments continue carrying forward to future years. Departments are supposed to review commitments and accounts payable to ensure they are accurate, and cancel any that are no longer needed. Canceling commitments and accounts payable releases funding for future appropriation.

Commitments

DPW had 17,400 commitments, totaling approximately \$180 million, at the beginning of FY 2012-13. We noted that \$65 million (36%) of DPW's commitments were over one year old and \$20 million (11%) were over three years old. Commitments outstanding for more than one year may no longer be needed because departments generally receive goods and services within a year of placing an order.

We reviewed 22 of DPW's commitments and noted that 10 (45%) commitments, totaling \$5.6 million, should have been canceled because they were no longer needed (e.g., received all services, etc.). DPW has canceled, or is in the process of canceling, most of these commitments.

We also reviewed 20 payments charged against other commitments during FY 2012-13, and noted that two payments (10%), totaling \$157,200, were for services that DPW had received during the prior FY. DPW should have established accounts payable, not commitments, for these services. As a result, expenditures in the prior FY were understated and expenditures in the current FY were overstated.

Accounts Payable

DPW had an average of \$12 million in accounts payable at the beginning of FYs 2009-10, 2010-11, and 2011-12, of which \$2 million (17%) per year was never used. DPW also had \$9 million in accounts payable at the beginning of FY 2012-13. We reviewed 15 of these accounts payable and noted that they were established appropriately.

We also reviewed 15 payments charged against current year encumbrances during FY 2012-13, and noted that one payment (7%), totaling \$56,400, was for services that were ordered and received during the prior FY. DPW should have established the encumbrance, and associated accounts payable, in the prior year.

Recommendations

Department of Public Works management:

- 1. Reinstruct staff on County Fiscal Manual requirements for establishing encumbrances, commitments, and accounts payable.**
- 2. Review commitments and accounts payable to ensure they are needed and cancel them if they are no longer required.**

Trust Funds

DPW has 28 trust funds that are made up of approximately 100 sub-accounts. The trust funds are primarily used to account for various collections and security deposits related to construction projects.

Trust Fund Oversight

County departments may use trust funds to account for money held as a custodian for third parties (e.g., refundable deposits, money received on behalf of other agencies, etc.), restricted donations, unearned revenue, and earned revenue until the appropriate allocations are identified. We noted that DPW inappropriately used one (4%) trust fund as a revolving cash fund that replenished a checking account used to purchase rights-of-way. The purchases should have been made using the normal expenditure process.

Trust fund activity should also be monitored, and trust funds should be closed when no longer needed (e.g., intended purpose ended, etc.). We noted that three (11%) trust funds were no longer needed. We identified that one of these trust funds has not had

activity for over seven years. DPW has closed, or is currently in the process of closing, the three trust funds.

Departments must also maintain trust fund originating documentation that identifies the trust fund's intended purpose and authority to ensure that clear standards are in place for trust fund usage (e.g., allowable transactions, etc.). We noted that DPW could not provide originating documentation for 14 (50%) trust funds. However, DPW does have a schedule that identifies each trust fund's intended usage. In the future, DPW should maintain originating documentation when establishing new trust funds.

Recommendations

Department of Public Works management:

- 3. Monitor trust fund activity, verify that trust fund use is consistent with County guidelines, and close trust funds that are no longer needed.**
- 4. Maintain originating documentation when establishing new trust funds.**

Trust Fund Balances

Departments should continuously monitor trust fund balances and ensure that money is transferred or disbursed in accordance with County guidelines. We examined 13 trust fund deposits, totaling \$3.3 million, to determine whether it was appropriate for the deposits to remain in trust. We noted that DPW should have moved \$514,300 (16%) out of trust funds, as follows:

- **Earned Revenue:** DPW should have recognized \$283,700 in earned revenue by transferring the money to revenue accounts. The revenue was from projects DPW completed.
- **Reimbursements:** DPW should have reimbursed \$230,600 in security deposits to developers because they completed the required infrastructure improvements for planned developments.

In addition, we noted that DPW received \$200,000 from a developer in 1999 to perform perpetual maintenance on median landscaping. DPW deposited the funds into trust and has continued to maintain the median, but has not recognized any revenue to cover the associated costs. DPW should have made most of the transfers and disbursements over five years ago.

Recommendation

- 5. Department of Public Works management continuously monitor trust fund balances and ensure the money is transferred or disbursed in accordance with County guidelines.**



GAIL FARBER, Director

COUNTY OF LOS ANGELES
DEPARTMENT OF PUBLIC WORKS

"To Enrich Lives Through Effective and Caring Service"


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November 20, 2014

IN REPLY PLEASE
REFER TO FILE: FI-2

TO: John Naimo
Auditor-Controller

FROM: Gail Farber 
Director of Public Works

**RESPONSE TO REVIEW OF COMMITMENTS,
ACCOUNTS PAYABLE, AND TRUST FUNDS**

We reviewed your audit report for the Department of Public Works, and we are in agreement with your recommendations. As indicated in the attached response, we concur with the findings and have either implemented or partially implemented the recommendations contained in your report. We have initiated corrective actions to address each recommendation.

We will continue to monitor our commitments, accounts payable, and trust funds to ensure they are cancelled timely when no longer needed. This includes timely trust fund transfers and disbursements. We thank you for assistance in cancelling prior-year encumbrances. We will continue to work with your office to complete the remaining cancellations.

We appreciate your team's professional and courteous conduct during this audit.

AC:dbm

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Attach.

County of Los Angeles
Department of Public Works
Response to Findings and Recommendations for Commitments, Accounts
Payable and Trust Funds' Review

Accounts Payable

Recommendations

DPW management ensures staff:

- 1. Reinstruct staff on County Fiscal Manual requirements for establishing encumbrances, commitments, and accounts payable.**

Response: Agree and Implemented

We will continue to enforce compliance by reinstructing personnel on County Fiscal Manual requirements for establishing encumbrances, commitments, and accounts payable.

- 2. Review commitments and accounts payable to ensure they are needed and cancel them if they are no longer required.**

Response: Agree and Partially Implemented

We cancelled a majority of the commitments and accounts payable that are no longer needed. We will continue to review commitments and accounts payable to ensure they are accurate and cancel any that are no longer needed. We are working with the Auditor-Controller's office to cancel prior-year procurement encumbrances since we do not have the mechanism to efficiently close the open balances. On May 29, 2014, the Auditor-Controller completed the mass cancellations of Fiscal Years 2009, 2010, and 2011 procurement encumbrances. We continue to seek assistance in cancelling Fiscal Years 2012, 2013, and 2014 and any other prior-year procurement encumbrances we are unable to close.

Trust Fund Oversight

Recommendations

DPW management ensures staff:

- 3. Monitor trust fund activity, verify that trust fund use is consistent with County guidelines, and close trust funds that are no longer needed.**

Response: Agree and Implemented

We have closed all the trust funds that are no longer needed.

County of Los Angeles
Department of Public Works
Response to Findings and Recommendations for Commitments, Accounts
Payable and Trust Funds' Review

4. Maintain originating documentation when establishing new trust funds.

Response: Agree

We will ensure that all new trust funds originating documentation are maintained and filed electronically as part of perpetual records.

Trust Fund Balances

Recommendations

DPW management:

- 5. Department of Public Works management continuously monitor trust fund balances and ensure the money is transferred or disbursed in accordance with County guidelines.**

Response: Agree and Partially Implemented

We have recognized the earned revenue for the completed projects and refunded security deposits for completed planned developments. We review the aging reports on a quarterly basis to determine whether the deposits should be held or refunded. In addition, we are assessing how to further enhance our monitoring efforts to ensure timely recognition of revenue and disbursement.